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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 1997)

Docket No. R97-1

Direct Testimony of

DR. JOHN HALDI

Concerning

THE PROPOSED STANDARD A MAIL PARCEL SURCHARGE

on Behalf of

NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, SEATTLE FILMWORKS, INC., AND
MERCK-MEDCO MANAGED CARE, L.L.C.

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December 30, 1997

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AUTOBIOGRAPHICAL SKETCH

My name is John Haldi. I am President of Haldi Associates, Inc., an economic and management consulting firm with offices at 680 Fifth Avenue, New York, New York 10019. My consulting experience has covered a wide variety of areas for government, business and private organizations, including testimony before Congress and state legislatures.

In 1952, I received a Bachelor of Arts degree from Emory University, with a major in mathematics and a minor in economics. In 1957 and 1959, respectively, I received an M.A. and a Ph.D. in economics from Stanford University.

From 1958 to 1965, I was assistant professor at the Stanford University Graduate School of Business. In 1966 and 1967, I was Chief of the Program Evaluation Staff, U.S. Bureau of Budget. While there, I was responsible for overseeing implementation of the Planning-Programming-Budgeting (PPB) system in all non-defense agencies of the federal government. During 1966 I also served as Acting Director, Office of Planning, United States Post Office Department. I was responsible for establishing the Office of Planning under Postmaster General Lawrence O'Brien. I established an initial research program, and screened and hired the initial staff.

1 I have written numerous articles, published consulting studies, and co-
2 authored one book. Included among those publications are an article, "The
3 Value of Output of the Post Office Department," which appeared in *The*
4 *Analysis of Public Output* (1970); a book, *Postal Monopoly: An Assessment of*
5 *the Private Express Statutes*, published by the American Enterprise Institute
6 for Public Policy Research (1974); an article, "Measuring Performance in Mail
7 Delivery," in *Regulation and the Nature of Postal Delivery Services* (1992);
8 and an article, "Cost and Returns from Delivery to Sparsely Settled Rural
9 Areas," in *Managing Change in the Postal and Delivery Industries* (1997;
10 with L. Merewitz).

11 I have testified as a witness before the Postal Rate Commission in
12 Docket Nos. MC96-3, MC95-1, R94-1, SS91-1, R90-1, SS86-1, R84-1, R80-1,
13 MC78-2 and R77-1. I also submitted comments in Docket No. RM91-1.

1 I. PURPOSE OF TESTIMONY

2 The purpose of my testimony is to subject to critical evaluation the
3 Postal Service's newly-proposed residual shape surcharge in Standard A Mail
4 (hereinafter "proposed Standard A parcel surcharge" or "proposed
5 surcharge"). I show that imposition of the surcharge would likely lead to
6 extensive repackaging of mailpieces, an expenditure by mailers that could
7 perversely reduce Postal Service revenues, while increasing handling
8 costs, thus producing the opposite of the outcome sought by the proposal. I
9 further demonstrate that the cost basis underlying the proposed surcharge is
10 gravely defective, and that de-averaging of transportation costs used to
11 justify the surcharge is inconsistent and inequitable vis-a-vis destination
12 entry discounts. As proposed, the surcharge should be rejected.

13 Should the Commission nevertheless decide to impose a surcharge,
14 then at the very least, the same averaging principles that are used to
15 estimate shipping costs avoided for destination entry discounts should be
16 used to estimate shipping costs incurred for parcels subject to the
17 surcharge. It would violate principles of fairness and equity to reflect the
18 incurrence of the higher shipping cost of parcels by imposition of a parcel
19 surcharge, while not reflecting the avoidance of the same higher shipping
20 costs of parcels in developing destination entry discounts for parcels.

1 **II. INTERVENORS' MAILING PRACTICES**
2 **AND INTEREST IN THE PROPOSED**
3 **STANDARD A MAIL PARCEL SURCHARGE**

4 This testimony is presented on behalf of five intervenors. Four are
5 photofinishers: Nashua Photo Inc. ("Nashua"), which does business as York
6 Photo Labs, District Photo Inc. ("District") which does business as Clark
7 Color Lab, Mystic Color Lab ("Mystic"), and Seattle FilmWorks, Inc.
8 ("Seattle"), collectively referred to as "NDMS."¹ Each firm is a through-the-
9 *mail film processor which receives exposed film through the mail, and uses*
10 the Postal Service to return developed film and prints to its customers. The
11 fifth intervenor is Merck-Medco Managed Care, L.L.C.

12 **Overview of the Film Processing Industry**

13 Collectively, through-the-mail film processors account for
14 *approximately 6 percent of the domestic film processing market. The*
15 remaining 94 percent of the market is divided among a large number of local,
16 regional and national (e.g., Eastman Kodak, through Qualex, Inc., and Fuji
17 Photo Film, through Fuji Trucolor Inc.) film processing companies that rely
18 on the general public taking its film to a drop-off location and then returning

¹ Although not an intervenor herein, another through-the-mail film processor, Skrudland Photo Inc., has joined with and supports the position of NDMS.

1 to the drop-off location to pick up the finished prints. In some localities,
2 competitors do on-site developing and printing, and offer turn-around times
3 as short as one hour.

4 Turn-around time and service are critical considerations in the direct
5 mail photofinishing business. All four companies operate their respective
6 processing plants up to 24 hours a day, seven days a week, as demand
7 warrants. Their goal is to have finished pictures back into the mail within 24
8 hours after customers' film arrives at the plant.

9 Nashua, District, Mystic, and Seattle compete vigorously with each
10 other, but they compete even more with the multitude of local, regional and
11 national film processors described above.

12 **Mailing Practices of Nashua, District, Mystic and Seattle**

13 Exposed rolls of film are received from customers accompanied by
14 orders to develop the film and make prints. Most rolls of film have 24 or 36
15 exposures, and customers may order a single or double set of prints. The flat
16 strips of developed film, cut into suitable lengths and enclosed in protective
17 jackets, are placed inside paper, Tyvek®, or plastic envelopes, together with
18 any prints or enlargements which are stacked inside. The resulting
19 envelopes are then dropshipped via expedited service to the appropriate SCF,
20 where they are entered as Standard A Mail. Envelopes containing sets of
21 prints are either flat- or parcel-shaped, a packaging decision that is currently

1 not driven by postage costs. Parcel-shaped mailpieces are almost always
2 mailpieces that would be classified as flats if they did not exceed the
3 maximum flat thickness of 3/4". Standard A Mail envelopes mailed by
4 NDMS that are parcel-shaped currently constitute about 30-40 percent of
5 NDMS's Standard A Mail pieces.

6 **Mailing Practices of Merck-Medco Managed Care, L.L.C.**

7 Merck-Medco Managed Care, L.L.C., is a subsidiary of Merck & Co.,
8 Inc., and is the leading pharmacy benefits manager in the United States.
9 Merck-Medco manages pharmaceutical care for millions of Americans
10 covered by employer-funded health plans, major insurance carriers, labor
11 unions, public sector programs, and managed care plans. It uses Standard A
12 Mail to distribute pharmaceuticals to its customers. Many of these
13 mailpieces would be classified as flats except for exceeding the maximum flat
14 thickness of 3/4".

1 **III. BACKGROUND INFORMATION ON THE PROPOSED**
2 **STANDARD A MAIL PARCEL SURCHARGE**

3 The Postal Service's Standard A Mail rate design witness has proposed
4 a surcharge of 10 cents per piece for all parcels.² The surcharge would apply
5 to all pieces which exceed any of the following dimensions: height of 12",
6 width of 15", or thickness of 3/4".³ The surcharge would apply to all
7 Standard A Mail parcels, so defined, without exception, and without any
8 consideration of whether such parcels were machinable. It would also apply
9 to any other Standard A Mail "prepared as parcels" (*e.g.*, flats).⁴

10 The proposal to impose a surcharge on Standard A parcels appears to
11 have been prepared by the Postal Service in response to the concern
12 expressed in the Commission's decision in Docket No. MC95-1, which
13 discussed whether parcels should be charged a higher rate based upon their
14 unit costs. Commissioner LeBlanc's dissenting opinion observed that:

15 Parcels come in many shapes and sizes. It is not likely that any
16 rate schedule can be devised to account for the attributable costs
17 of each possible shape or size of parcel. The Commission does
18 know, however, that parcels are not letters or flats, and thus, by
19 definition, they are a residual element of third-class. The

² USPS-T-36, pp. 11-15.

³ These are the maximum dimensions of a flat, as defined in DMM §C050.3.1.

⁴ USPS Request, Attachment A, pp. 25-26.

1 Commission also knows, since the Postal Service tells it, that, on
2 average, regular third-class parcels are subsidized at
3 approximately 10 cents per piece and enhanced carrier route
4 parcels are subsidized at approximately 7 cents per piece. This
5 is enough information to establish a surcharge for parcels. [*Op.*
6 *& Rec. Dec.*, Docket No. MC95-1, Dissenting Opinion of Vice-
7 Chairman W.H. "Trey" LeBlanc, pp. 1-2.]

8 **Supporting Cost and Revenue Data**

9 The only data supporting the proposed surcharge in this docket are
10 those supplied by witness Crum.⁵ Revenue and volume data for parcels
11 supplied by witness Crum are summarized here in Table 1. As shown in this
12 table, almost nine-tenths (88.5 percent) of all parcels which would be subject
13 to the surcharge are in the Standard A Mail Regular subclass. The volume of
14 nonprofit parcels is comparatively small, less than 5 percent of all Standard
15 A parcels (and less than 0.4 percent of all nonprofit bulk mail). The volume
16 of commercial rate ECR parcels is likewise comparatively small.

⁵ USPS-T-28 (revised 10/1/97), Appendix K, pp. 10-12.

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Table 1
FY 1996 Bulk Standard A Mail IPPs and Parcels
Revenues and Volumes
(000)

	Revenue	Volume	Dist. (%)
ECR			
Commercial Rate	10,992	69,464	7.07%
Nonprofit	178	1,389	0.14%
	-----	-----	-----
All ECR	11,170	70,853	7.21%
REGULAR			
Commercial Rate	403,812	869,434	88.48%
Nonprofit	11,232	42,360	4.31%
	-----	-----	-----
All Regular	415,044	911,794	92.79%
	-----	-----	-----
All Standard A	426,214	982,647	100.00%

Source: USPS-T-28 (revised 10/1/97), Exhibit K, Tables 1 and 2.

24 The per-piece revenue and cost data for parcels provided by witness
25 Crum are shown in Table 2, along with the average weight per piece. The
26 average weight of Standard A Mail Regular parcels is 8.9 ounces. The
27 average revenue is 46.4 cents. Using the Postal Service's costing approach
28 and data, the average cost is 51.3 cents. Finally, according to these Postal
29 Service estimates, on average, costs exceed revenues by **4.9 cents** per piece.⁶

⁶ Witness Moeller refers to this difference as the "below cost rate problem."
USPS-T-36, p. 12, l. 9.

1 Unit cost data for the other subclasses are seen to vary considerably,
2 probably because of the small volumes involved, and should be considered as
3 highly unreliable.⁷ Aggregating these unreliable data, for all parcels in all
4 four subclasses of Standard A, the Postal Service estimates that average
5 parcel revenues amount to 43.4 cents, while costs average 51.6 cents. These
6 estimates thus imply that (i) parcels are being “cross-subsidized” at
7 approximately 8.2 cents per piece, and (ii) the proposed 10-cent surcharge
8 would eliminate completely any such cross-subsidy.

9 **Projected Volumes and Revenues of Standard A Parcels**

10 Without the surcharge, rate increases proposed for Standard A
11 Regular nonletters (the subclass with almost 90 percent of all Standard A
12 parcels) range up to 7 percent. For pieces subject to the surcharge, however,
13 rate increases for non-destinating entry pieces range from 12 percent (for a
14 piece that weighs between 15 and 16 ounces) to 51 percent (for a piece that
15 weighs less than 3.3 ounces). The proposed surcharge would impose an
16 increase of 55.6 percent on minimum-per-piece 3/5-digit presort parcels
17 entered at a DSCF.⁸

⁷ See Section VI, *infra*, for a critique of the cost data used to support the surcharge.

⁸ See witness Moeller’s response to NAA/USPS-T36-4 (Tr. 6/2777).

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Table 2			
FY 1996 Bulk Standard A Mail IPPs and Parcels			
Average Revenues, Cost and Weight			
(\$ per piece)			
	Revenue	Cost	Weight (oz.)
ECR			
Commercial Rate	0.158	0.455	2.77
Nonprofit	0.128	1.382	3.06
	-----	-----	
All ECR	0.158	0.473	2.78
REGULAR			
Commercial Rate	0.464	0.513	8.90
Nonprofit	0.265	0.659	6.40
	-----	-----	
All Regular	0.455	0.520	8.78
	-----	-----	
All Standard A	0.434	0.516	8.35
Source: Cost: USPS-T-28 (revised 10/1/97), Exhibit K, Table 3.			
Average revenue computed from Table 1.			

23 Despite the high percentage rate increases proposed for parcels,
24 witness Moeller estimates that test year after-rates volume of Standard A
25 parcels will amount to 1.2 billion,⁹ an increase of 22 percent over the reported
26 1996 volume of 982 million (shown in Table 1). This rather substantial

⁹ Response of witness Moeller to PSA/USPS-T36-8 (Tr. 6/2886). This statement is somewhat at variance with witness Moeller's statement that the Postal Service had not calculated Test Year After Rates volume, attributable cost, or revenue-per-piece data for Standard A flats or residual pieces. See response of witness Moeller to PSA/USPS-T26-1 (Tr. 6/2887).

1 percentage increase in volume seems implausible, given that the own-price
2 elasticity for all Standard A Mail is -0.382.¹⁰

3 **Overview of Testimony**

4 As indicated above, the only revenue, volume and cost data supporting
5 the surcharge proposal are those presented by witness Crum. Those data are
6 discussed in more detail in Section VI. First, however, it is important to note
7 that the Postal Service fails to examine certain immediate and foreseeable
8 consequences that are likely to result from the surcharge as proposed. These
9 are discussed in Section IV. In addition to a study of obvious consequences
10 which ought to have been performed and submitted, the Postal Service
11 presentation is also noticeably lacking in a number of other important
12 respects. These shortcomings are discussed in Section V. My
13 recommendations are contained in Section VII.

¹⁰ USPS-T-6, p. 115. Separate own-price elasticities are not computed for letters, flats, and parcels.

1 IV. THE PROPOSED SURCHARGE WOULD CREATE
2 UNINTENDED PERVERSE INCENTIVES

3 As shown in Table 1, *supra*, the Postal Service estimates that
4 approximately 982 million Standard A Mail mailpieces were classified as
5 parcels in 1996, and witness Moeller projects 1.2 billion Standard A parcels
6 will be subject to the surcharge in Test Year. Should all of these pieces
7 continue to be mailed as parcels, a surcharge of 10 cents per piece would cost
8 mailers an additional \$98 to \$120 million each year. Postal Service revenues,
9 of course, would increase by the same amount. For many industries,
10 including (but not limited to) through-the-mail film processing, the proposed
11 10-cent surcharge represents a staggering added expense.

12 In highly competitive industries, firms are under constant, tremendous
13 pressure to reduce any expense that does not add value. In the case of the
14 proposed Standard A parcel surcharge, the additional expense could be
15 avoided by repackaging the contents of a parcel-shaped package into a
16 mailpiece with flat-shaped dimensions.¹¹ Parcel-shaped packages are often
17 used currently because the cost of postage and envelopes are lower than

¹¹ Witness Moeller observed that certain mailpieces meet the definitions of both parcels and flats. (Tr. 7/3161, ll. 8-19). In fact, he said that it was no secret that "some parcel mailers may ... be able to avoid the surcharge by mailing their smaller parcels as flats." (Tr. 7/3162, ll. 7-11).

1 repackaging such mailpieces as flats. Aside from economy, however, parcel-
2 shaped mailpieces generally do not provide mailers with any added value
3 over a flat-shaped mailpieces. Therefore, one can predict with a high degree
4 of confidence that virtually all parcel mailers whose product gives them a
5 repackaging option will in fact seek to repack their products into flat-
6 shaped mailpieces if confronted with a significant surcharge for parcels.

7 Moreover, packaging firms and design consultants will have a field
8 day if the proposed Standard A parcel surcharge is implemented as proposed.
9 For such suppliers, the proposed surcharge will create a veritable host of new
10 marketing opportunities. Thus, one immediate and highly predictable result
11 of the Standard A parcel surcharge would be a massive repackaging of
12 mailpieces now classified as parcels. In light of this consideration, the
13 consequences of possible repackaging would appear to fall into the category
14 of readily foreseeable but nevertheless “unintended consequences,” which
15 must be examined carefully.

16 **Unintended Consequences**

17 The proposed Standard A parcel surcharge is extremely poorly
18 conceived. It would be imposed on every mailpiece that exceeds any one of

1 the limits for a flat-shaped piece, and it would not be imposed on any
2 mailpiece that conforms to those dimensions.¹²

3 It is essential to recognize, however, that "flat-shaped" is not
4 necessarily synonymous with "easy-to-handle" or "low-cost." As discussed in
5 more detail below, some flat-shaped mailpieces can be more awkward to
6 handle than many parcels in their existing shape, and can present carriers
7 with new problems in delivery. Yet the proposed surcharge neither
8 recognizes nor gives any incentive for machinability or other characteristics
9 to promote ease of delivery.¹³ Consequently, it contains no incentive to
10 reduce the Postal Service's cost — except, perhaps, by reducing volume
11 mailed.¹⁴

12 This is a serious shortcoming. What needs to be recognized is that **the**
13 **surcharge may increase the Postal Service's costs far more than ever**
14 **thought**, while failing to produce the forecasted revenues. These
15 unintended consequences are likely to result from repackaging of a
16 substantial proportion of Standard A Mail now classified as parcels. Such

¹² The maximum dimensions for a flat are 15" width, 12" height and 3/4" thickness (DMM §C050.3.1).

¹³ See response of witness Moeller to NDMS/USPS-T36-4 (Tr. 6/2819).

¹⁴ The Postal Service regularly takes account of own-price elasticity in its forecasts. As noted previously, however, the only effect predicted by witness Moeller is an astounding 22 percent increase in volume. See, e.g., witness Moeller's response to PSA/USPS-T36-8 (Tr. 6/2886), where he estimates a bulk Standard A parcel volume subject to the surcharge of 1.2 billion in Test Year 1998.

1 repackaging will involve items now packaged by mailers in parcel-shaped
2 pieces that resemble flats except that they are more than 3/4" thick. Many of
3 these pieces can now be sorted mechanically on an SPBS, and fit easily into
4 ordinary residential mailboxes.

5 Whenever pieces contain multiple stacked items (*e.g.*, photographic
6 prints, Christmas cards, checks, compact disks, etc.), the contents could be
7 repackaged readily through side-by-side placement into thinner stacks. So
8 long as the resulting package is less than 3/4" thick, it would meet the
9 definition of a flat, thereby avoiding the surcharge and reducing revenue
10 below that forecast. The resulting package might be (i) a rigid box, or (ii) an
11 envelope with internal compartments designed to maintain thickness below
12 the 3/4" limit for a flat. Either of these repackaging strategies could impose
13 significant extra costs on the Postal Service, compared with the costs
14 incurred in handling parcels in their present shape, especially when the
15 existing parcel is readily machinable and the repackaged piece is non-
16 machinable.

17 **The Rigid Box Option**

18 If mailers chose to repackage the contents into a rigid box, the size of
19 the box could go up to the current maximum dimensions allowed for flats, *i.e.*,
20 12" x 15" x 3/4" without incurring the parcel surcharge. Whether FSM 881s
21 or FSM 1000s could handle boxes of such dimensions is not known. Such

1 boxes presumably could be sorted manually into a vertical flat case, or
2 perhaps on an SPBS.¹⁵ In terms of the delivery function, maximum size flats
3 may cause extra costs because they would not fit inside the standard "rural"
4 mailbox (about 9" to 10" high), which is common in many suburban and rural
5 locations, nor into a standard post office box or the typical apartment house
6 mailbox, all of which can readily accommodate many more than 3/4" thick
7 "parcels" in their existing form. Thus, repackaging into large rigid boxes
8 could make mail processing and/or delivery tasks more cumbersome, more
9 time consuming, and therefore more costly to the Postal Service.¹⁶

10 **The Compartmentalized Envelope Option**

11 Alternatively, should mailers choose to repackage into an envelope
12 with compartments, this would result in the same incentive to approximate
13 the maximum dimensions for flats, with consequences perhaps even more
14 adverse than the rigid box option. For example, envelopes, especially highly
15 flexible ones such as those of the plastic Tyvek® variety, when divided into
16 internal compartments, would be inclined to flip-flop about a horizontal or

¹⁵ If the contents in their present parcel form (*i.e.*, before repackaging) are being sorted on the SPBS, the Postal Service would not gain any cost reduction in mail processing cost from the repackaging. It would simply have some amount of flat-shaped pieces added to the parcel mailstream.

¹⁶ These extra costs would of course be charged to "flats." Although a quite real added expense, it would be virtually impossible for the IOCS to distinguish and identify the extra costs that would be loaded onto flats.

1 vertical dividing axis while being processed, not only defeating machinability
2 but also making manual sortation into vertical flat cases more cumbersome
3 and costly.

4 The added costs imposed on the Postal Service by the more
5 cumbersome handling of either close-to-maximum size rigid boxes or
6 compartmentalized envelopes created by repackaging could very well exceed
7 any added revenue obtained from the parcel surcharge on those packages
8 that do not convert or are simply not sent. In that event, everyone would
9 lose. Thus, although some mailers would pay the added surcharge, others
10 would engage in a perverse **negative cost sharing** by incurring additional
11 packaging expenses that, instead of reducing Postal Service total handling
12 costs, would actually increase those costs. And the Postal Service's gain in
13 extra revenue from the surcharge may not be sufficient to offset the extra
14 costs of handling the perversely-created cumbersome flats.

15 In addition, imposition of the surcharge might have a negative societal
16 impact, even in the event that the Postal Service managed to recoup from the
17 surcharge its extra costs of handling more cumbersome flats created by
18 repackaging. This outcome would result if the extra repackaging costs for
19 the mailers, plus the extra handling costs for the Service, jointly exceeded
20 revenues from the surcharge.

1 **Summary**

2 The Standard A parcel surcharge, as proposed by the Postal Service in
3 this docket, is extraordinarily myopic. It contains no incentives for reducing
4 Postal Service costs, either via increasing the machinability of parcels or by
5 other increased worksharing. As indicated above, mailers' only incentive
6 would be to repackage, which could lead to unintended and
7 counterproductive effects on the Postal Service's bottom line. Should such
8 mischief result, the net incentive effect of the surcharge could turn out to be
9 highly perverse, and certainly not revenue-enhancing. The surcharge is not
10 even intended, as I show in the next section, to deal with the balance
11 between revenues and costs; it is narrowly focused on cost differences whose
12 conceptual underpinnings are seriously defective.

1 **V. SHORTCOMINGS OF THE POSTAL SERVICE'S PROPOSED**
2 **SURCHARGE FOR STANDARD A PARCELS**

3 **The Proposal Focuses Myopically on Costs**

4 In Docket No. MC95-1, the Commission was concerned that revenues
5 from parcels were less than the costs attributed to parcels. Witness Moeller
6 testifies that the proposed Standard A residual shape surcharge was
7 developed in response to concerns expressed by the Commission in Docket
8 No. MC95-1 about costs exceeding revenues, and mentions in passing the
9 “below cost” problem.¹⁷ Presumably this refers to the 8.2 cent difference
10 between average revenues and costs developed by witness Crum.

11 Nevertheless, witness Moeller states that “the difference between
12 revenues and costs” incurred by parcels “is **not relevant** to the rate design”
13 underlying the residual shape surcharge.¹⁸ He further explains why the
14 comparison between the average revenue and the average cost incurred by
15 the average Standard A parcel is not relevant to the surcharge: “[t]he point
16 of the surcharge isn’t to assure cost coverage or that the revenues exceed the
17 costs; it is to recognize cost differences between these two groupings of

¹⁷ USPS-T-36, p. 12.

¹⁸ See responses of witness Moeller to NDMS/USPS-T36-1-2 (Tr. 6/2816-17) (emphasis in original).

1 mail.”¹⁹ In other words, the sole basis of the Postal Service’s justification for
2 the surcharge is on (i) the **cost** of handling parcels, and (ii) the **difference**
3 **in cost** between parcels and flats — not the difference between parcel
4 revenues and costs.

5 **Cost Models are Woefully Deficient**

6 In light of the expressed concern about the cost of handling parcels, it
7 is remarkable that the Postal Service has not presented one single cost model
8 showing how any parcel is handled. This lacuna in the cost presentation
9 stands in sharp contrast to the detailed cost models for letters and flats
10 presented by witnesses Daniel and Seckar.²⁰ The Postal Service’s direct case
11 is silent regarding:

- 12 (i) productivity achieved by processing parcels on a Small
13 Parcel and Bundle Sorter (“SPBS”);
- 14 (ii) productivity rates of the SPBS with and without a
15 barcode reader;
- 16 (iii) which characteristics prevent certain parcels from being
17 sorted on a SPBS;
- 18 (iv) the extent to which parcels could be processed on the
19 FSM 1000; and

¹⁹ Tr. 6/2947, ll. 22-24 and Tr. 6/2948, ll. 7-11 and 19-22.

²⁰ USPS-T-29 and USPS-T-26, respectively.

1 (v) any plans to improve mechanization and the way small
2 (under 16 ounce) parcels are handled.²¹

3 Instead, the Postal Service's entire case relies solely on an IOCS-based
4 cost study.

5 **The Causative Roles of Shape and Weight Are Ambiguous**

6 That parcels cost more, on average, to handle than flats would seem to
7 be a reasonable proposition, notwithstanding various problems with witness
8 Crum's cost study. For example, on average, parcels weigh more than flats.
9 Consequently, since Standard A rates above the breakpoint are weight-
10 based, the average parcel pays a higher rate than flats. The first issue that
11 needs to be addressed is the extent to which weight is a causal factor, as
12 opposed to shape. To his credit, witness Moeller recognizes the importance of
13 developing evidence documenting what drives or causes a cost difference.
14 Where two hypothetical mailpieces of different shapes and weights have
15 identical cost and revenue differentials, he observes²²

16 that's a good thing that the revenue is being obtained for this
17 additional cost of 33 cents but **ideally you would want to**

²¹ The silence is all the more noteworthy since the Commission in Docket No. MC95-1 explicitly took note of RIAA's criticisms regarding the lack of data supporting a separate Standard A parcel rate, including: **no definition** parameters of affected mailpieces, **no identification** of the different procedures (and resultant costs) for machinable and nonmachinable parcels, and **no analysis** of potential volume shifts among classes and subclasses of mail. *Op. & Rec. Dec.*, Docket No. MC95-1, para. 5544.

²² Tr. 7/3158, 11. 12-21 (emphasis added).

1 **know what's causing that cost difference.** The pound rate
2 is the right mechanism for getting that additional revenue if it
3 is indeed weight that was causing the cost difference in that
4 hypothetical. To the extent it was shape that was driving that
5 difference, then there would be a basis for a shape surcharge
6 and a lowering of the pound rate because weight would not have
7 been what was causing the cost difference of 33 cents.

8 Witness Moeller went on to state that, "I think we have a study that
9 shows that shape is a big cost determinant."²³ His reference, presumably, is
10 to witness Crum's cost study, discussed in Section VI, *infra*.

11 The role of cost drivers, as they affect the relative costs of letters, flats,
12 and parcels of different subclasses, will be taken up in more detail in Section
13 VI in connection with the discussion of the adequacy of cost data used to
14 support the proposed parcel surcharge. It is necessary, however, to comment
15 here further on the role of cost drivers *within* parcels; *i.e.*, within the residual
16 category of mailpieces known as parcels and IPPs, which in itself comprises
17 the largest variations of shape within all Standard A Mail.

18 **Cost Differences and Cost Drivers Within Parcels Are Not Studied**

19 A major failure of the Postal Service's filing in this case is the lack of
20 any study demonstrating how the cost of handling various types and shapes
21 of parcels varies with different cost-driving characteristics. In Docket No.
22 MC95-1, the Commission cited RIAA's observation that "the calculation of the

²³ Tr. 7/3159, ll. 1-2.

1 'average cost' of a 'parcel' proves nothing about the range of costs that made
2 up that average."²⁴ For example, do rolls, other odd shapes, and "outsides"
3 have extremely high unit costs, which drive up the average cost of all
4 parcels? The IOCS-based cost study sponsored by witness Crum exhibits
5 remarkable, virtually unbelievable, cost differences for parcels of similar
6 weight. Are these cost differences based on real cost-driving characteristics?
7 Or do they simply illustrate the futility of relying exclusively on IOCS tallies
8 to study parcel costs?

9 On the one hand, if the substantial cost differences developed by
10 witness Crum are real, they need to be investigated in order to identify cost-
11 drivers and quantify their impact. But no information is forthcoming on this
12 important issue. Witness Crum appears indifferent to potentially important
13 questions raised by his own study.

14 On the other hand, if the cost differences are spurious, and amount to
15 nothing more than statistical outliers caused by small sample size, of course
16 they should be disregarded. But how much weight can the Commission, or
17 anyone else for that matter, give to a study if it produces statistically
18 meaningless results and literally begs to have disregarded the important
19 differences which it surfaces?

²⁴ *Op. & Rec. Dec.*, Docket No. MC95-1, para. 5547.

1 The Postal Service presentation totally lacks any suggestion or insight
2 — such as how to reduce costs or improve worksharing — that might be
3 helpful to either the Commission or mailers. The proposal is simply an
4 across-the-board surcharge based on the limited information provided by
5 IOCS tallies. The study is extremely limited, as well as disappointing,
6 because of its failure to examine any aspect of the “parcel problem,” except to
7 manipulate IOCS tallies. And, since the IOCS-based study is all that is
8 available in this docket, and could be the sole or principal source of cost
9 information in future dockets, one problem deserves special mention —
10 namely, the collection of cost data pertinent to the proposed parcel surcharge.

11 **The Definition of a Standard A Parcel**
12 **Presents Fundamental Problems**

13 By definition, parcels are neither letters nor flats. This is not to say,
14 however, that a meaningful distinction exists between parcels and flats in
15 Postal Service practice. As will be seen, for example, identical size and shape
16 mailpieces can be flats or parcels, depending on the context. Consequently,
17 vagaries of Postal Service practices and procedures promote the conclusion
18 that the terms “parcel” and “residual shape” may not provide meaningful
19 criteria for purposes of determining accurate costs, or cost differentials, or for
20 the design of cost-based rates.

1 **The Rural Carrier Cost System Definitions**
2 **of Letter, Flat and Parcel**

3 Witness Crum observed that “the way rural parcels are counted in the
4 rural carrier cost system there [are] different dimensional criteria”.²⁵ In the
5 rural carrier cost system, all mailpieces with a height exceeding 5" are
6 considered parcels, especially if the item is rigid and cannot be folded.²⁶ In
7 other words, a rigid greeting card or Christmas card between 5" and 6½" high
8 that would ordinarily be classified as a “letter” under the DMM is identified
9 as a **parcel** in the rural delivery system.²⁷ Obviously, a rigid flat in any of
10 the most common sizes (*i.e.*, 8½" x 11", 10" x 13", 11" x 14", and 12" x 15") also
11 would be identified as a parcel. Perhaps unsurprisingly, this is not the only
12 instance where flats and parcels can have identical dimensions.

13 **The Surcharge Would Apply to Flat-Shaped Mailpieces**
14 **That Are “Prepared As Parcels”**

15 The Postal Service’s filing in Docket No. R97-1 requests the following
16 changes to the Domestic Mail Classification Schedule:²⁸

²⁵ Tr. 17/8092, ll. 2-4.

²⁶ See Tr. 17/8098, ll. 16-17.

²⁷ Tr. 17/8098, l. 12 to 17/8099, l. 19.

²⁸ USPS Request, Attachment A, pp. 25-26. The language here reflects a conscious change by the Postal Service from similar provisions proposed in Docket No. MC97-2, which would have based the surcharge solely on dimensions of the mailpiece.

1 **321.25 Residual Shape Surcharge.** Regular subclass
2 mail is subject to a surcharge if it is prepared as a
3 parcel or if it is not letter or flat shaped.

4 **321.37 Residual Shape Surcharge.** Enhanced Carrier
5 Route subclass mail is subject to a surcharge if it is
6 prepared as a parcel or if it is not letter or flat
7 shaped.

8 As noted above, witness Moeller stated “it is no secret” that flats and
9 parcels can have the same dimensions. Yet witness Moeller repeatedly
10 commented that mailpieces of identical weight and dimensions (length,
11 width, and height) incur different costs depending on how they are
12 characterized — as parcels or flats.²⁹

13 Witness Moeller’s testimony characterized the surcharge as applying
14 to every “piece of Standard A Mail that is neither letter- nor flat-shaped.”³⁰
15 However, as counsel for RIAA discussed with witness Crum, under the Postal
16 Service’s proposals some flat-shaped (but “parcel-prepared”) mailpieces
17 would also be subject to the surcharge.

18 Evidently, witness Crum was unaware that the surcharge would apply
19 to mailpieces prepared as a parcel, regardless of shape. He stated that his
20 definition of a parcel, undergirding his testimony supporting the surcharge,
21 was drawn from the IOCS-defined categories of IPP Machinable, IPP

²⁹ See responses of witness Moeller to DMA/USPS-T36-3 (Tr. 6/2740),
DMA/USPS-T36-9 (Tr. 6/2747), and NAA/USPS-T36-5 (Tr. 6/2778).

³⁰ USPS-T-36, p. 12, ll. 15-16.

1 Nonmachinable, Parcel Machinable, and Parcel Outside, which definitions
2 parallel that of DMM §C050.³¹ Yet, as counsel for RIAA pointed out, and
3 witness Crum confirmed, the definitions of a parcel defined by IOCS and
4 DMM §C050 — and relied upon by witness Crum in his analysis — do not
5 reflect a mailpiece’s “preparation as a parcel.”³²

6 In fact, witness Crum confirmed the overlap between the dimensions of
7 flat-shaped pieces and of nonletter, nonflat-shaped pieces.³³ Witness Crum
8 noted that flat-shaped pieces may well have been identified as parcels by
9 IOCS tally takers (whose data formed the basis for witness Crum’s analyses
10 in Exhibit K).³⁴

11 **Volume and Cost Data for Parcels Need To Be Consistent**

12 The Postal Service uses separate data systems for collecting
13 information on (i) revenues and volumes, and (ii) costs. In order to obtain
14 meaningful data for rate making purposes, it is essential that in each of the
15 two systems mailpieces be identified in the same manner. That is, all pieces
16 subject to the parcel surcharge should be identifiable as a parcel under the

³¹ See responses of witness Crum to NDMS/USPS-T28-3 (Tr. 5/2200) and NDMS/USPS-T28-13 (Tr. 5/2226).

³² Tr. 5/2375 l. 17 to 5/2376, l. 4; Tr. 5/2380, l. 9 to 5/2381 l. 8.

³³ Tr. 5/2377, ll. 5-10; Tr. 5/2381, ll. 4-13.

³⁴ Tr. 5/2384, ll. 2-7.

1 IOCS.³⁵ Otherwise, there could be, and to a certain extent there may be,
2 chaos. In light of the Postal Service's current procedures and practices, it is
3 submitted that neither the concept of "parcel" nor "residual mail" are
4 meaningful criteria from which to estimate costs or design rates. In this
5 docket, RIAA's oral cross-examination of witness Crum has drawn out the
6 fact that the Postal Service's current residual shape surcharge proposal
7 expressly would treat identical mailpieces differently, if one identical
8 mailpiece is prepared as a flat and the other identical mailpiece is prepared
9 as a parcel. Moreover, no mechanism exists by which the Postal Service has
10 been able to identify correctly the actual shape of such mailpieces when
11 collecting the data used to compute cost allocations. The IOCS instructions
12 used to identify flats and parcels in the mainstream rely on DMM §C050,
13 which does not refer to preparation as a criterion distinguishing flats from
14 parcels.³⁶

15 **Conclusion**

16 Although the proposal for a Standard A parcel surcharge is narrowly
17 — indeed, myopically — focused on costs, the conceptual foundation of the
18 cost data used for rate making is gravely deficient. Cost models are lacking:

³⁵ See ANM-T-1 for further discussion concerning problems that arise when revenues and volumes are not identified in the same manner as costs.

³⁶ Tr. 6/2372-84.

1 the causative roles of shape, weight, and other potentially important factors
2 are ambiguous; cost differentials and cost drivers within the category of
3 parcels have not been subjected to statistical study; and even the
4 identification of mailpieces as parcels as between the RPW system and IOCS
5 is problematic. Instituting a surcharge, which will result in rate increases of
6 up to 50 percent, on a conceptual foundation shot through with such defects
7 would be questionable in the extreme.

1 **VI. ANALYSIS OF COST DATA USED TO SUPPORT**
2 **THE STANDARD A PARCEL SURCHARGE**
3

4 The testimony of witness Crum presents a detailed breakdown of cost
5 segment data (i) by subclass and (ii) by shape (letters, flats and parcels) to
6 de-average the cost of parcels.³⁷ Using data in witness Crum's tables, the
7 volume-variable unit cost for mail processing and delivery of parcels has been
8 computed; see Table 3.

9 **Mail Processing Costs Exhibit Wide Differences**

10 Examination of Table 3 reveals extremely wide variation in mail
11 processing unit costs. Bulk Rate Regular ("BRR") ECR parcels have the
12 lowest unit cost, 14.62 cents, and the lowest average weight, 2.77 ounces.³⁸
13 This is the only rate category with a rational correlation with weight. Bulk
14 Rate Nonprofit ("BNP") ECR parcels have the highest unit cost for mail
15 processing (about 37 cents), while their average weight is somewhat less than

³⁷ USPS-T-28 (revised 10/1/97), Exhibit K, Tables 3A(1), 3A(2), 3B(1) and 3B(2).

³⁸ Reclassification changes were implemented for the former third-class regular rate mail on July 1, 1996. For the former third-class nonprofit rate bulk mail, reclassification changes became effective on October 6, 1996, after the end of the 1996 fiscal year.

1 BRR Other. With respect to the high volume-variable unit cost for nonprofit
2 parcels, witness Crum states:³⁹

3 Please refer to my response to NDMS/USPS-T28-19,....
4 One might expect unit cost fluctuations when volumes are of
5 that level. **I can not definitively vouch for the stability or**
6 **one year accuracy of the results for Nonprofit ECR**
7 **parcels in isolation** particularly when they are broken out
8 into even smaller pieces not specifically referred to in my
9 testimony. The Nonprofit specific results were included
10 separately only in response to intervenor requests and in the
11 interest of providing a complete record....
12 **I am unaware of any difference in processing steps that**
13 **would explain the difference in unit costs.** (Emphasis
14 added.)
15

16 Table 3

17 Volume-Variable Unit Costs and
18 Average Weight for Parcels
19 FY 1996

	Mail Processing Cost (cents)	Delivery Cost (cents)	Average Weight (ounces)
Bulk Regular Rate (BRR)			
ECR	14.62	28.43	2.77
Other	29.01	12.61	8.90
Bulk Nonprofit (BNP)			
ECR	36.72	99.42	3.06
Other	37.05	22.29	6.40
All Parcels	28.35	14.27	8.35

30 Source: USPS-T-28 (revised 10/1/97), Exhibit K,
31 Tables 3A(1), 3A(2), 3B(1) and 3B(2).

³⁹ See response of witness Crum to NDMS/USPS-T28-31 (Tr. 17/8012, 8033).

**Presort Cost Savings From Parcels
Are Underestimated and Not Studied**

As noted above, the different rate categories exhibit wide differences in mail processing costs for parcels. Aggregating mail processing costs over all parcels yields an average figure of 28.4 cents. This is almost six to seven times more than the average mail processing cost of letters or flats, which amount to 4.1 and 4.9 cents, respectively. Witness Crum indicates that the lower unit costs for letters and flats in part reflect a higher degree of presortation; he estimates that adjusting parcel unit cost for both presort and dropship differences accounts for about 5.1 cents of the difference.

Clearly, if mail processing costs are as high as estimated by witness Crum, then presortation of parcels would (and does) result in cost avoidances that are far greater than those that result from presortation of flats. In other words, the more it costs to sort something, the greater is the cost avoidance from presortation. Presorted parcels are thus being “short-changed” when the Postal Service uses cost avoidances based on flats. Moreover, since parcel presort discounts are grossly understated with respect to full cost avoidance, the Postal Service is failing to provide desirable incentives and price signals that would encourage parcel mailers to undertake more presortation.

As pointed out in Section V, *supra*, the root of the problem is that the Postal Service has (i) no detailed models of parcel processing flows comparable to those presented on the record for letters and flats, (ii) no

1 productivity figures for SPBSs, with or without barcode readers, and (iii) no
2 downflow density data, all of which are necessary to develop accurate presort
3 discounts.⁴⁰

4 **Delivery Costs Exhibit Even Wider**
5 **Differences Than Mail Processing Costs**

6 The volume-variable unit costs for delivery in Table 3 are the sums of
7 all costs in segments 6, 7 and 10 divided by the respective volumes. The
8 results for delivery costs are even more disparate than for mail processing
9 costs. BRR Other has the **lowest** unit cost (12.61 cents), but the **highest**
10 average weight (8.9 ounces). BRR ECR has a unit cost of 28.43 cents, and an
11 average weight of 2.8 ounces. With respect to the cost difference (15.82
12 cents) between BRR ECR and Other parcels, witness Crum offers a few
13 conceivable reasons why there might be “slightly higher costs for ECR
14 parcels.”⁴¹

15 The average weight of BNP ECR (3.1 ounces) is almost two-thirds less
16 than BRR Other, while the unit cost, **99.42 cents**, is almost **8 times**
17 **greater**. When asked to explain the dramatic cost difference between BRR
18 and BNP (70.99 cents), witness Crum simply referred to his previous

⁴⁰ The absence of so much critical data and other pertinent information can be easily overlooked, which is reminiscent of Sherlock Holmes’ case of the “dog that didn’t bark.”

⁴¹ See response of witness Crum to NDMS/USPS-T28-32(b) (Tr. 17/8036).

1 response, quoted above, which provides no insight or explanation
2 whatsoever.

3 **Cause of Mail Processing and Delivery**
4 **Cost Differences Are Not Identified**

5 The data supplied by witness Crum raise troubling questions. Parcels
6 with a comparatively low unit mail processing cost have a comparatively high
7 delivery cost, and variations in unit cost appear uncorrelated, or even
8 inversely correlated, with weight differences. For parcels under 16 ounces,
9 weight may or may not be a significant cost driver with respect to mail
10 processing and delivery costs. But treating weight as of minor importance
11 raises significant questions that call for answers. That is, are these cost
12 differences meaningful at all? Do these cost differences **reflect real**
13 **characteristics that differ among the various shapes of different**
14 **parcels?** Or do they represent nothing more than statistical variation
15 arising from small sample size?

16 The cost differences are so enormous as to render the data worthless.
17 Some unit costs appear to be several standard deviations from the average.
18 If they reflect real, shape-driven causality (e.g., rolls, spheres or other
19 unusual shapes), then the Commission and the Postal Service need to know
20 far more about them, and mailers deserve to have them quantified in a
21 statistically reliable manner. A simple one-size-fits-all 10-cent surcharge

1 would barely begin to recover the unusually large costs caused by such odd-
2 shaped parcels, if such parcels are driving these costs, while imposing an
3 unjust burden on parcels whose handling costs differ only slightly, if at all,
4 from those of flats. To make things worse, the proposed surcharge may
5 potentially create substantial problems in the category of “unintended
6 consequences,” as discussed previously in Section IV of this testimony.

7 **Uncertainties and Inconsistencies**
8 **Associated with Transportation Costs**

9 Witness Crum de-averages the volume-variable transportation costs of
10 Standard A Mail by distributing those costs using estimates of the cubic
11 density of letters, flats and parcels. The de-averaging of transportation costs
12 presents two important difficulties:

- 13 • The estimated density for parcels is subject to considerable
14 uncertainty; and
- 15 • Destination entry discounts are inconsistently based on cost
16 avoidances that have not been de-averaged; *i.e.*, that are
17 averaged over letters, flats and parcels.

18 **Different Density Estimates for Standard A Mail Parcels**

19 The estimates of density for Standard A Mail parcels are subject to
20 great uncertainty, as cross-examination of witness Crum by counsel for
21 AMMA and other parties has established. The two most recent studies
22 undertaken by the Postal Service have resulted in parcel densities that differ

1 by a ratio of almost 2:1. A density of 14.93 pounds per cubic foot was
2 developed in a previous study.⁴² In this docket, witness Crum relies on a
3 slightly more recent study. Using an entirely different methodology, this
4 second study yields a figure of 8.01 pounds per cubic foot for commercial
5 parcels, and 8.12 pounds per cubic foot for commercial and non-commercial
6 parcels combined.⁴³

7 In the prior study, average density was derived by weighing containers
8 that had been filled with a random sample of parcels, then dividing the
9 weight by the volume of the container.⁴⁴ Potential for error with this method
10 is inherent in how the container is packed.

11 In the later study, average density was derived by weighing parcels
12 individually and estimating the volume from measurements of length and
13 girth. Potential for error with this method is inherent in how the individual
14 volume of each parcel is calculated, since length and girth were the only
15 measurements available for any parcel in the study.⁴⁵ Taken together, length
16 and girth are insufficient to determine the volume of even a fairly
17 regular-shaped parcel, let alone one that is of irregular shape. To estimate

⁴² Docket No. MC95-1, LR-PCR-13.

⁴³ Tr. 17/8059-8060, ll. 5-8.

⁴⁴ Tr. 17/8061, ll. 15-16.

⁴⁵ Tr. 17/8066-67.

1 volume, it was necessary for witness Crum to make additional assumptions
2 so obscure that he was unable to explain them on the witness stand.⁴⁶

3 For the present docket, witness Crum uses the density of 8.1 lbs/cubic
4 foot for parcels, which was derived by the second method described above.⁴⁷
5 *The variance between the two very different estimates of density is startling.*
6 Cross-examination brought out witness Crum's lack of awareness that the
7 methodology of the earlier study was less subject to human error of
8 measurement for different samples of parcels than the later study.⁴⁸ Clearly,
9 this raises serious doubts, especially in regard to sources of error in
10 measurement, as to whether the later estimate that witness Crum uses in
11 this docket is not in fact inferior to the earlier estimate.

12 Using a parcel density of 15 pounds per cubic foot, rather than 8
13 pounds per cubic foot, would almost halve the estimate of attributable
14 transportation costs, a major cost component for parcels, thereby reducing
15 significantly the estimated cost difference between flats and parcels. For all
16 parcels, the average cost for vehicle service drivers (cost segment 8) and
17 transportation (cost segment 14) is 8.84 cents. The vast majority of these
18 costs are distributed by cube. Using the higher density in the previous Postal

⁴⁶ See Tr. 17/8067-68.

⁴⁷ USPS-T-28, Exhibit K, Table 3 (revised 10/1/97).

⁴⁸ Tr. 17/8062-63.

1 Service study would reduce this average cost by about 4 cents per piece,
2 which is approximately one-half of the revenue shortfall now asserted by
3 witness Crum.

4 **Destination Entry Discounts Are Based**
5 **On Average Transportation Costs**

6 Destination entry discounts for Standard A Mail are developed in LR-
7 H-111. That study assumes throughout that all Standard A Mail has the
8 same density. That assumption is acceptable when all other costs for
9 Standard A Mail are developed by averaging together letters, flats and
10 parcels in the customary top down approach to cost development and rate
11 design. However, it is completely inconsistent with the de-averaging of costs
12 carried out by witness Crum. Not only is it totally inconsistent, but it would
13 also be unfair and inequitable to parcel mailers to charge them extremely
14 high transportation costs based on a tenuous Postal Service estimate of
15 density, on the one hand, while denying them destination entry discounts
16 based on the exact same Postal Service estimate, however tenuous it may be,
17 on the other.

18 **Two Ways to Resolve the Inconsistency**

19 Should the Commission decide to impose a surcharge, it can resolve
20 the inequity discussed above in one of two ways:

1 • Estimate the cost of parcels using average transportation
2 costs for letters, flats and parcels combined, consistent
3 with the average transportation costs used to develop
4 destination entry discounts; or

5 • De-average the destination entry discounts for parcels,
6 using the same density that is assumed when estimating
7 bottom up transportation costs of parcels.

8 If the Commission opts to use the average transportation cost for
9 letters, flats and parcels, which amounts to approximately 0.5 cents, the
10 average cost of parcels will be reduced by about 6.6 cents, and unit cost will
11 exceed average revenue by only about 1.6 cents. Witness Moeller proposes a
12 10-cent surcharge to cover a purported deficit of 8.2 cents. Witness Moeller's
13 "margin" is thus 1.8 cents, which exceeds the purported deficit by about 22
14 percent. Using the same 1.8-cent margin, the surcharge would be reduced to
15 3.4 cents, while setting the surcharge at 122 percent of the deficit would
16 result in a surcharge of 2.2 cents. This option has several merits.

17 • First, it leaves the established method of determining
18 destination entry discounts in place, untouched.

19 • Second, it does not require separate destination entry
20 discounts to be derived and assessed for different shapes;
21 hence, it is simple.

22 • Third, it avoids all controversy and uncertainty
23 concerning the correct density of parcels.

24 • Fourth, a more modest surcharge will invite far fewer
25 unpleasant surprises arising from any unintended
26 consequences, such as widespread repackaging.

1 Further, all of these results could be obtained while better data would
2 be collected, as mailing statements would be prepared more accurately in
3 specifying shape, since parcel shape, for the first time, would have Standard
4 A Mail rate consequences. Therefore, in the future, these data on parcels
5 would be more reliable than at present, when forms may be filled out which
6 carelessly mis-identify shape, because there are no rate consequences
7 whatsoever.

8 On the other hand, should the Commission disagree with my proposal,
9 and instead decide to de-average transportation costs for parcels using either
10 of witness Crum's density estimates, fairness would require the Commission
11 to recompute separate de-averaged destination entry discounts for parcels.
12 The parcel discounts will of course be larger (significantly so, if the lower
13 Postal Service estimate of density is used). While separate discounts for
14 parcels are a more complex option than a lower surcharge, larger destination
15 entry discounts for parcels would have the merit of promoting more
16 dropshipment (*i.e.*, greater worksharing), which not only would save
17 transportation costs, but would also avoid some mail processing functions.
18 Since the discounts for presortation and destination entry of parcels are both
19 understated, giving parcels a destination entry discount that fully reflects
20 cost avoidance would seem both fair and desirable in allowing mailers of
21 parcels the opportunity to offset that portion of the surcharge being imposed.

1 **VII. CONCLUSIONS AND RECOMMENDATIONS**

2 **Conclusions**

3 The Postal Service proposal for a Standard A Mail parcel surcharge
4 lacks merit in four critical respects.

5 **1. Unintended consequences.** As proposed, the surcharge is poorly
6 formulated, with even the most obvious issues not even touched upon.

- 7 • It creates a powerful incentive to repackage parcels
8 into flats wherever feasible. Inescapably, that will
9 reduce revenues from the surcharge.
 - 10 • More importantly, the costs of handling repackaged
11 parcels could increase sharply over existing costs
12 for handling the same contents in their existing
13 form.
 - 14 • The contribution to overhead, instead of being
15 increased, may actually be reduced.
 - 16 • The net impact on the Postal Service, as well as the
17 mailing public, taken together, could very well be
18 negative.
- 19 **2. Lack of desirable incentives.** As proposed, the surcharge:
- 20 • gives mailers no incentives to reduce Postal Service costs by any
21 known method; *e.g.*, by increased machinability, barcoding,
22 presortation, or destination entry; and
 - 23 • fails to distinguish between parcels that have dimensions,
24 handling, and cost characteristics similar to flats, and truly
25 awkward irregular packages with inherently high handling
26 costs.

1 **3. Defective cost estimates.**

- 2 • The cost estimates proffered are shot through with critical
3 shortcomings and fail to support the proposed rates.

4 **4. Inconsistency and inequity.**

- 5 • Cost **incurrences** are de-averaged, while cost
6 **avoidances** are not.
- 7 • To be consistent and equitable, handling and shipping
8 costs used to support the parcel surcharge should be
9 reflected in symmetrical fashion in the structure of
10 presort and destination entry discounts. The proposed
11 parcel surcharge fails this simple test.

12 **Primary Recommendation**

13 For the foregoing reasons, I strongly suggest that the Commission
14 defer recommending any parcel surcharge based on the Postal Service's
15 proposal in this docket. As proposed, the surcharge is not well thought out.
16 In fact, it may well create far more problems than it solves.

17 **Secondary Recommendation**

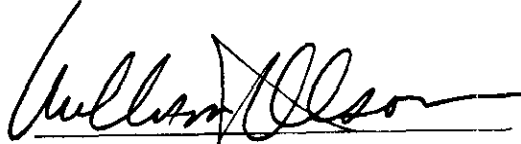
18 Should the Commission feel that some action is necessary at this time,
19 it should consider recommending a shell classification, without any specific
20 rate, and request the Postal Service to submit a new proposal which
21 addresses the more important deficiencies of the current proposal.

22 Should the Commission nevertheless feel compelled to go beyond a
23 shell classification, and should it adopt witness Crum's de-averaged bottom-

- 1 up costs as the basis for a surcharge at this time, then I suggest that the
- 2 surcharge not exceed 2 to 3 cents, for the reasons set out herein.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.


William J. Olson

December 30, 1997